



**STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS**

DRAFT

Date:	02/22/13	Bill No:	Assembly Bill 1203
Tax Program:	Sales and Use	Author:	Gorell
Sponsor:	Author	Code Sections:	RTC 6595
Related Bills:	SB 209 (Lieu)	Effective Date:	01/01/14

This analysis only addresses the portion of the bill that impacts the Board of Equalization (BOE).

BILL SUMMARY

This bill prohibits the assessment of interest and penalties for sales or use tax liability due when a court determines the underlying statute is unconstitutional, under specified conditions.

ANALYSIS

CURRENT LAW

Except where the law provides a specific exemption or exclusion, California's Sales and Use Tax Law¹ imposes the sales tax on all retailers for the privilege of selling tangible personal property at retail in this state or the use tax on the storage, use, or other consumption in this state of tangible personal property purchased from a retailer.

Existing law provides for the imposition of a variety of penalties for noncompliance with the laws. An example of some of the penalties imposed under the Sales and Use Tax Law include:

Nature of Penalty	Rate	RTC Section
Failure to make a timely prepayment	6%	6476
Failure to file a return	10%	6511, 6591
Failure to make a timely payment	10%	6591
Negligence or intentional disregard of the laws or regulations	10%	6484
Fraud or intent to evade the law or regulations	25%	6485
Knowingly failing to obtain a valid permit in order to avoid tax	50%	7155
Improper use of a resale certificate for personal gain or to evade the tax	10%or \$500 ²	6072; 6094.5
Registration of vehicle, vessel, or aircraft out of state to evade the tax	50%	6485.1; 6514.1
Failure to obtain evidence that operator of catering truck holds valid seller's permit	\$500	6074

¹ Part 1 of Division 2 (commencing with Section 6001) of the Revenue and Taxation Code (RTC).

² 10% of the tax due or \$500, whichever is greater, plus any other applicable penalty.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

Generally, existing law³ authorizes the BOE to relieve specified penalties when the BOE finds that a person's failure to make a timely return or payment is due to reasonable cause and circumstances beyond the person's control, and occurred notwithstanding the exercise of ordinary care and the absence of willful neglect. To be relieved, the law requires taxpayers to file a statement under penalty of perjury setting forth the facts upon which he or she bases his or her claim for relief.

In addition to penalties, interest is imposed on a late tax payment, currently at a rate of six percent annually. The interest is computed from the tax due date to the last day of the month of payment. Generally, interest on a late tax payment is not relievable. However, under specified provisions⁴, the BOE is authorized to relieve interest:

- (1) When the BOE finds that a person's failure to make a timely return or payment was due to a disaster,⁵ and occurred notwithstanding the exercise of ordinary care and the absence of willful neglect.
- (2) Where the failure to pay tax is due in whole or in part to an unreasonable error or delay by a BOE employee acting in his or her official capacity.

Under these provisions, similar to relief of penalty requests, any person seeking relief of interest must file a statement under penalty of perjury setting forth the facts upon which he or she bases his or her claim for relief.

Under the law,⁶ if the BOE finds that a person's failure to timely file a return or make a payment is due to the person's reasonable reliance on BOE written advice, the person may be relieved of tax, interest and penalty. To be relieved, among several other requirements prescribed, the law requires the person to have requested in writing for advice as to the taxability of a particular activity or transaction, and the BOE to have responded in writing to the person stating whether or not the described transaction or activity or transaction is subject to tax.

Under this provision, persons seeking relief must also file a statement under penalty of perjury setting forth the facts upon which the claim is based.

PROPOSED LAW

This bill prohibits the BOE from assessing interest and penalties related to a person's failure to make sales or use tax payments if all of the following apply:

- The BOE must collect the tax due to a court holding that a statute is unconstitutional;
- The taxpayer relied on the unconstitutional statute when calculating the amount of tax due; and
- The taxpayer paid the tax within 60 days after the BOE sent a notice of determination to the taxpayer related to the tax the BOE must collect.

Similar provisions apply to the Franchise Tax Board (FTB).

³ RTC 6592.

⁴ RTC 6593, 6593.5.

⁵ The BOE's Regulation 1703 defines "disaster" to mean fire, flood, storm, tidal wave, earthquake or similar public calamity, whether or not resulting from natural causes.

⁶ RTC 6596.

BACKGROUND

In 1993, the Legislature provided for the exclusion or deferral of gain from qualified small business stock (QSBS). This exclusion generally conformed to federal law. However, California law required at least 80 percent of the company's payroll at the time of the stock purchase to be within California and 80 percent of assets and payroll to be within California during the taxpayer's holding period for the stock in order to qualify for a QSBS gain exclusion or deferral. The provisions in California law regarding the 80 percent asset and payroll requirements were found to be unconstitutional in August 2012 by the California Court of Appeal in *Cutler v. Franchise Tax Board*, 208 Cal.App.4th 1247 (2012).

Following the *Cutler* decision, the FTB issued Notices of Proposed Assessments to taxpayers who had previously relied on Sections 18038.5 and 18152.5. To remedy the discrimination against non-California taxpayers, the FTB denied the QSBS exclusion/deferral to all taxpayers for all periods not barred by the statute of limitations.

COMMENTS

1. **Sponsor and Purpose.** The author is sponsoring this bill to "prevent the imposition of a retroactive tax." This measure is intended to provide taxpayers, who follow statutes and published case law, a safe harbor from penalties and interest that may result when a statute upon which the taxpayer relied is found to be unconstitutional.
2. **Generally, a finality penalty on a BOE-issued notice of determination is imposed 30 days after the notice is mailed.** If the BOE determines a taxpayer owes tax, it sends taxpayers a notice of determination (billing). The notice indicates the amount due, and includes interest and penalty. If the taxpayer does not pay the tax liability by the due date on the notice (30 days from the date the determination was issued), an additional 10 percent penalty applies to the amount of overdue tax unless the taxpayer files a timely appeal. This measure requires payment within 60 days of a notice of determination in order to avoid penalty and interest.
3. **Bill streamlines penalty relief process.** A failure to make a timely tax payment due to a taxpayer's reliance on a statute subsequently determined to be unconstitutional would likely be considered a reasonable cause and circumstance beyond a taxpayer's control. Although interest would not generally be relievable under current law, a late payment penalty for this failure would likely be relievable under current law. However, before granting penalty relief, current law requires a taxpayer to file a statement under penalty of perjury setting forth the facts upon which he or she bases the claim for relief. This bill provides automatic relief in such cases. This streamlines the relief process for both the taxpayer and the BOE.
4. **Related Legislation.** SB 209 (Lieu) allows taxpayers receiving an FTB noticed assessment related to the denial of a QSBS gain exclusion or deferral from 2008 to 2012 to claim the exclusion or deferral despite the *Cutler* decision. The bill also reinstates the QSBS gain exclusion and deferral provisions beginning January 1, 2016.

COST ESTIMATE

Any administrative costs associated with this bill are absorbable.

REVENUE ESTIMATE

No revenue impact. Currently, the BOE has no pending sales and use tax cases that involve the constitutionality of a statute.

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